MICHAEL J. MURPHY
State Treasurer

Fourth Quarter 2002

The QUARTERLY

Local Government Investment Pool

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Is an economic recovery on its way?

The last quarter of calendar year 2002 gave investors more of the same signals of an economy experiencing a "jobless" economic growth recovery. Even Fed Chairman Greenspan pointed out that the economy hit a "soft patch" in its road to recovery. The current deterrent for more robust growth is still geopolitical worries, which prevent business investment spending and consumer consumption from climbing out of their current troughs. Signs of concern were apparent during the holiday season as retail stores experienced their worst fourth-quarter sales since 1970. Consumers were still worried about job losses, terrorism, the prospect of war with Iraq and mounting tension in North Korea.

Productivity gain and new home sales are the bright spots in this lower-than-anticipated growth recovery. U.S. worker productivity rose at an annual rate of 5.1 percent in the third quarter of CY 2002, the best rate in 30 years. Investments in equipment and software continued to pay dividends to companies in the form of higher efficiency. Meanwhile, home sales and mortgage refinancings were benefiting from the low interest rate environment. However, based on recent data, both catalysts seemed to be losing steam as mounting job losses and shaky consumer confidence are affecting buyers' sentiment.

The Federal Reserve unanimously reduced the fed funds rate by 50 basis points (bp) to 1.25 percent in November as an "insurance" for all the external factors that might negatively affect the U.S. economy. While most economists had predicted the Fed would ease, they were surprised by an easing of 50 bp. The targeted fed funds rate now stands at its lowest level in more than 40 years. The Fed, however, was quick to point out that it would be easy to unwind excesses from easing due to growing pressures on resources (i.e., inflation) if the economy showed signs of strengthening. This possibility seemed remote as FOMC minutes show it was more concerned with using alternative monetary tools to help a faltering economy and avoiding deflation. The committee issued a statement after the rate-cut that the "risks are balanced with respect to prospects for both goals (price stability and sustainable economic growth) in the foreseeable future."

The Fed Beige Book released in mid-January reinforced the views that the economy has not shown signs of meaningful recovery. Consumer spending was lackluster, with only auto sales showing signs of life, and this was due to heavy discounting. While manufacturing showed slight improvement, business capital spending was stagnant. Pricing power was also non-existent, as final goods' prices were subdued. The Beige Book report showed inconsistency with the Fed's initial assessment of risks to inflation and growth.

The December unemployment rate reached 6 percent while payrolls fell 101,000 for the same period. The Conference Board also announced that ratings of jobs hard to get rose to 29.8 percent, the highest since May 1994. These indicators bode ill for the U.S. economy. The Bush Administration announced that it would tackle the problem of unemployment as its number one priority. In order to create growth, the Bush Administration is leaning heavily toward a fiscal stimulus program to help the ailing economy.

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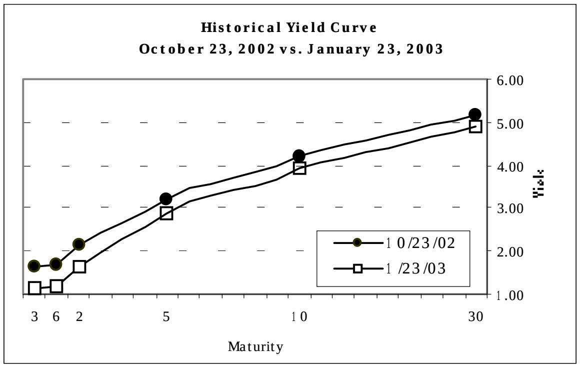
Market summary
from page 1

The uneven pace of the economy's gradual recovery needs more positive news, such as resolution to geopolitical worries, in order to sustain growth. The lack of pricing power forces businesses to absorb costs due to weak consumer demand. In addition, there is little desire to commit capital ahead of an impending war. The sub-par growth the country is experiencing has caused concern about how the economy will engineer a recovery from its "soft patch." Economists' consensus estimates for GDP expansion is around 2.7 percent for 2003, still alarmingly low compared to a typical sustainable recovery rate of 3 percent and above.

The stock market suffered its third consecutive annual decline, which has only happened twice in its history. The Dow Jones Industrial Average was down 16.76 percent, the NASDAQ lost 31.53 percent, and the S&P500 index tumbled 23.37 percent for CY 2002. Losses were attributed to weak consumer demand as the major populace cut back on major purchases even with interest-free financing offered by almost all major retailers. The cost of capital was ironically high as corporate malfeasance and accounting fraud made bond issuance a very expensive exercise. Corporate credit spreads, however, narrowed during the last three months of 2002 as bond investors looked to increase yield pick-up versus government bonds.

The bond market maintained its gains during the last quarter, as Iraq and North Korea continued to weigh down investors' optimism. The yields on the three- and six-month bills rallied 50 and 49 bp, respectively. While the 2-year rallied by 50 bp, the 5-year and 10-year both decreased by 30 bp, causing the 2-year sector to outperform them on a total return basis. Part of this was fueled by a fear of greater supply in the 5-year area to finance the President's stimulus package.

In accordance with its close ties to the targeted fed funds rate, the net return on the LGIP during the quarter ranged from 1.73 percent in October to 1.45 percent in December. Currently, the market consensus is for the Fed to hold rates unchanged. However, some believe the next move will be a tightening, while still others see the next move as an ease. At present, the average life of the LGIP portfolio is approximately 54 days, which represents a neutral outlook with respect to the Fed.



WSACT appoints Wolverton to LGIP Advisory Committee

State Treasurer Michael J. Murphy announced the appointment of Linda Wolverton, Spokane County Treasurer, to a three-year term as a representative of the Washington State Association of County Treasurers on the LGIP Advisory Committee.

In other business at the committee's Dec. 13 meeting, a brief update was given on the net LGIP returns for January through November 2002. The LGIP began 2002 at 2.07 percent and ended November at a rate of 1.55 percent. The targeted fed funds rate had held steady at 1.75 percent all year, until the November FOMC meeting at which it eased by 50 bp to 1.25 percent. The LGIP yield will be heading towards the fed funds rate, coming in around 1.4 percent for December, and around 1.3 percent for January 2003. There is an apparent nationwide trend of money leaving money market funds and going into bank deposits and possible implications if rates were to rise very quickly from the current levels.

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LGIP Advisory Committee

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Spokane County Treasurer
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The following article is second in the "Investing 101" educational series, which focuses on basic investment issues. We hope you find these articles informative and helpful. If you have comments or would like to suggest other topics for the series, call Lisa Hennessy at (360) 902-9013.

Investing 101
Managing Average Life
Part 1 – Repricing

Attaining peak performance

In the first article of the series, "The Targeted Fed Funds Rate," (The Quarterly, Third Quarter 2002) we mentioned that our goal in managing the LGIP portfolio is to lag the targeted fed funds rate as short as possible when rates rise and as long as possible when rates fall. We achieve this goal by managing the average life of the LGIP portfolio. Controlling the average life, using it as a resource to preserve or increase yield, is one of the most important factors in attaining peak performance of the portfolio.

What is repricing?

To effectively manage the average life of a portfolio, one must first understand the principle of repricing. As securities in a portfolio mature the cash must be reinvested. In other words, a portfolio will reprice to the current market. If the reinvestment yields are lower than the yield of the maturing securities, the portfolio yield will move lower. On the other hand, if yields are higher, the reinvestment will raise the portfolio yield.

The average life of a portfolio determines the speed at which the portfolio will reprice to the current market. The longer the average life of a portfolio, the longer it will take to reprice to the current market. Conversely, the shorter the average life of a portfolio the quicker it will reprice

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The Local Government Investment Pool will be closed on Monday, February 17, President's Day.

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Minutes
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A brief report on the Fiscal Year 2002 LGIP Audit was given. The audit was a success, and OST was pleased with the quality and professionalism of the CPA firm of Peterson Sullivan PLLC that performed the audit.

A review of the Fiscal Year 2003 budget was given. The LGIP average balance for FY 2002 was a record $5.3 billion. This resulted in more fees being collected than estimated and a larger rebate of about $1.39 million. The estimate of fees for FY 2003 is based on an estimated average balance of $4.4 billion. The actual fees and expenses for FY 2003, through October, are relatively close to the estimates. The estimated rebate for FY 2003 is now approximately $1 million.

A brief update was given on the TM$ project. On a positive note, the percentage of LGIP participants using TM$ has remained fairly stable, at around 60 percent. The account ledger can now be accessed back to July 1999, and a 12-month history is available for the account summary and the LGIP statement. Some members shared problems they were having accessing TM$, which may be partly due to a high volume of use of the internet during the holiday season.

There have been savings achieved due to administrative efficiencies brought about by TM$. The presence of TM$ has made it possible for a single LGIP Administrator to handle the significant growth seen by the LGIP over the last few years. Thus, in addition to providing value to participants in the arenas of making transactions and account information, TM$ is also providing cost savings to participants. The next phase of TM$ to affect the LGIP, although it will not be noticed by LGIP participants, is the addition of portfolio management/investment accounting.

Treasurer Murphy asked for input from the members about how often they would like to have meetings, such as quarterly or biannually. It was decided to put this item on the agenda for the March advisory committee meeting when more members are present to discuss this subject.

Investing 101

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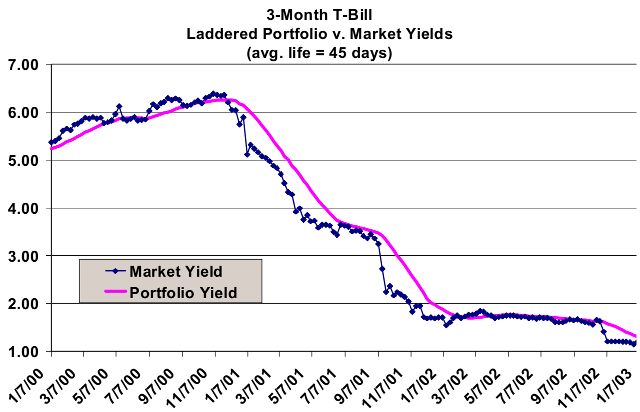
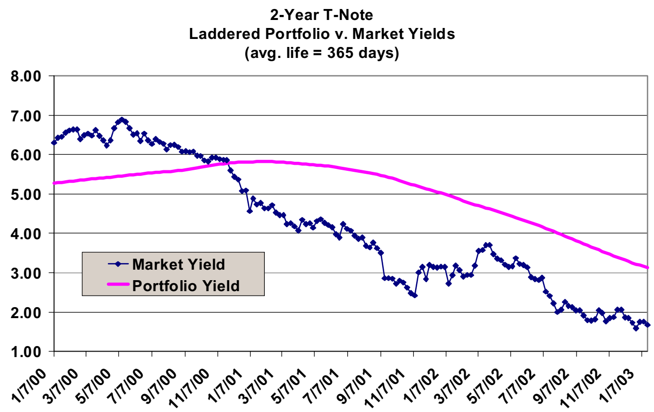
to the current market. As an example of repricing, let's compare two portfolios with different average lives and evaluate the speed at which they reprice to the current market. For this comparison we'll use two laddered portfolios: a three-month T-Bill portfolio with an average life of 45 days, and a two-year Treasury portfolio with an average life of 365 days. The following charts illustrate how the two portfolios repriced relative to the current market over the last three years.





As you can see from the charts, the shorter the average life the more closely the portfolio yield follows the current market. The difference between the portfolio yield and the market yield averaged 24 basis points for the shorter three-month T-Bill portfolio and 136 basis points for the longer two-year T-Note portfolio. The yield of the shorter portfolio is closely related to the market yield because the portfolio is repricing so quickly.

Put it to Work

We know that a portfolio will reprice to the current market. And now it's clear that the speed at which it reprices is influenced by the portfolio's average life. So how can we put that to work for us? Think about repricing as positive when interest rates are rising – as rates rise the portfolio reprices to a higher yield. We adjust to a shorter average life so the portfolio will reprice quickly to that higher yield. Regard repricing as negative when rates are falling – as rates fall the portfolio must reprice to a lower yield. When rates fall we adjust to a longer average life to preserve the yield we have and reprice more slowly to the lower yield. Once you understand this basic theory of repricing, you're on your way to developing an effective strategy for managing your portfolio.

Active strategy

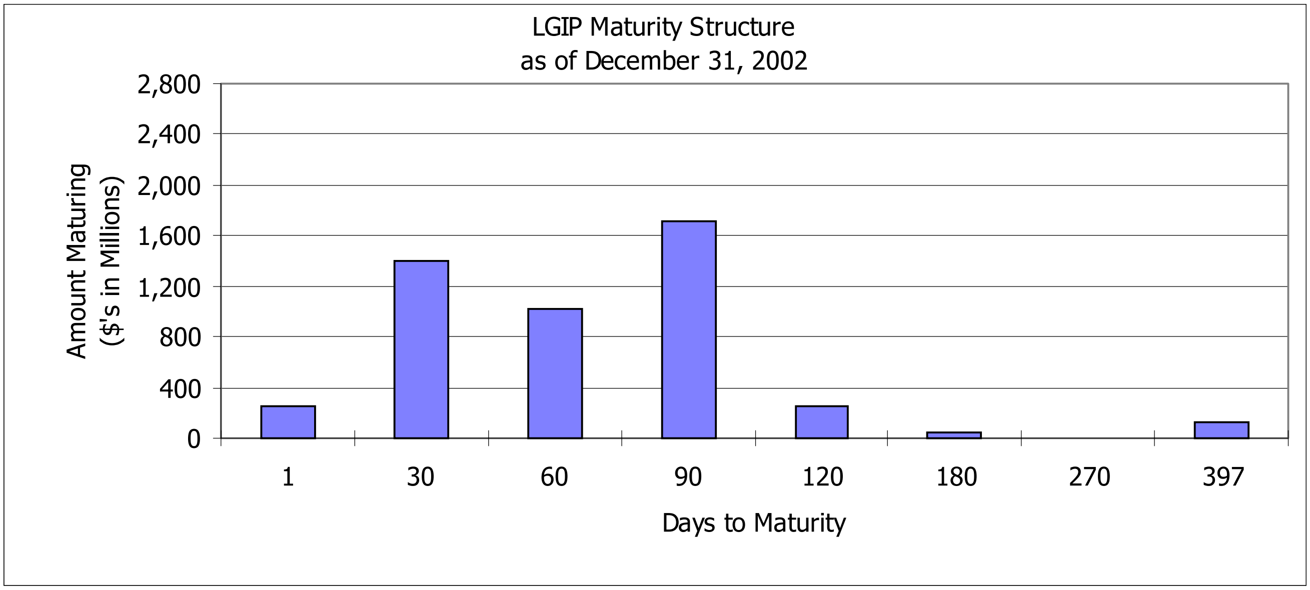
Clearly, average life is an important characteristic of a portfolio. Your investment policy should define limits with regard to not only the maximum maturity but also the maximum average life for the portfolio. Managing the portfolio's average life is an active portfolio strategy in which the manager adjusts the average life in order for the portfolio to reprice in the most advantageous manner.

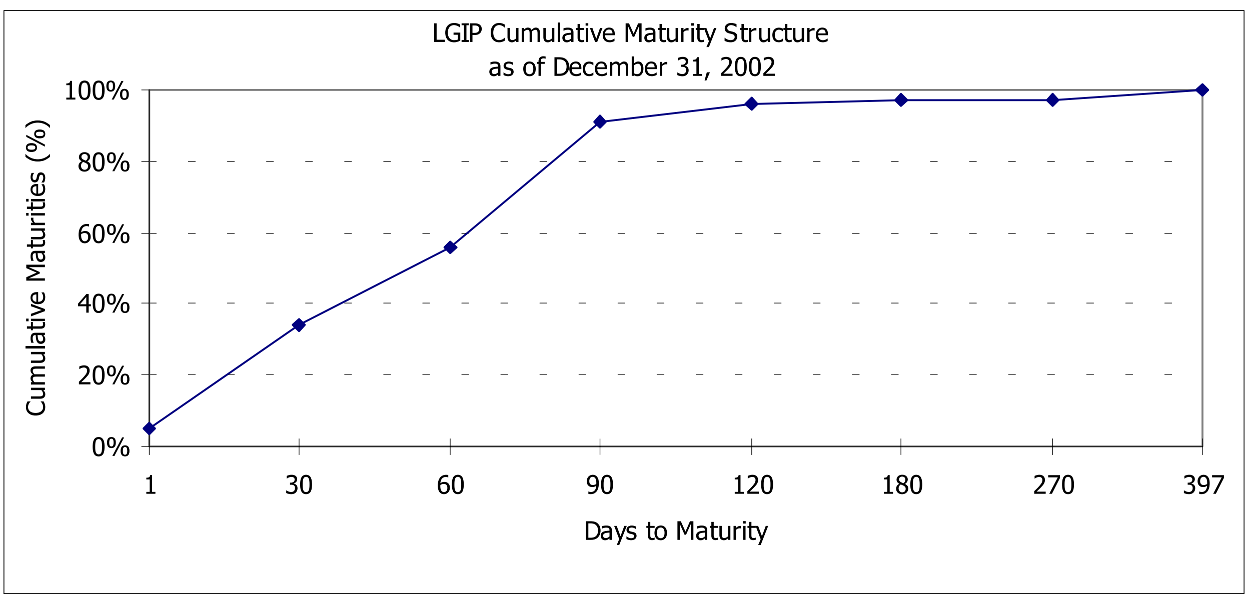
To employ this active strategy, it is necessary to develop guidelines for managing within the limitations of the investment policy. Those guidelines should include what represents a bullish, bearish or neutral average life. For example, the maximum average life of the LGIP is 90 days. We view 45-55 days as a neutral position, 35-45 days as a slightly bearish position, shorter than 35 days as bearish, 55-65 days as slightly bullish, and longer than 65 days as bullish. It is important to routinely compare the actual portfolio position with your interest rate outlook to ensure the two are consistent. For instance, an LGIP average life of 70 days would be inconsistent with a bearish interest rate outlook.

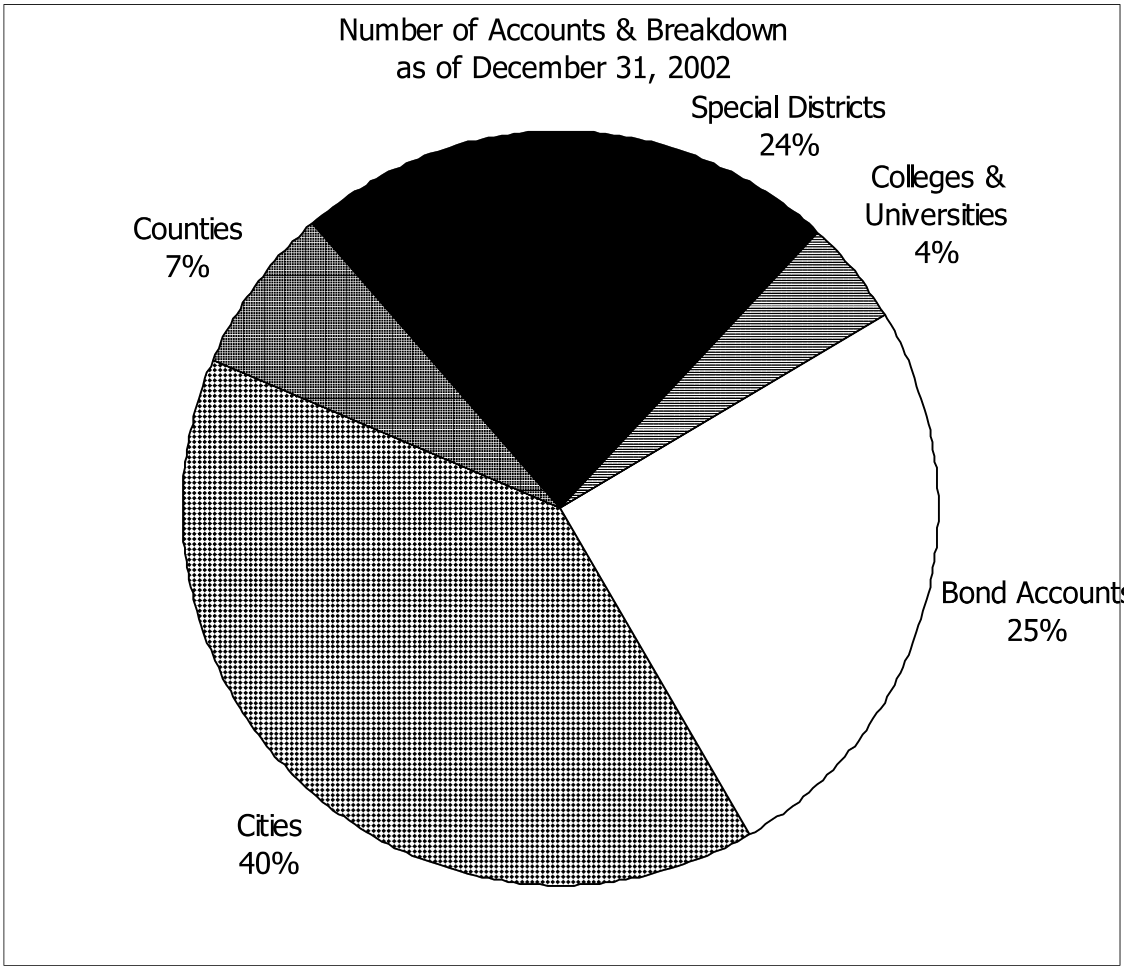
Use resources wisely

Because of its substantial impact on repricing of the portfolio, average life is a valuable resource in managing your portfolio. Use this resource wisely. The impact of proposed trades on the average life and yield of the portfolio should be thoroughly examined to ensure they fit with your overall portfolio strategy.

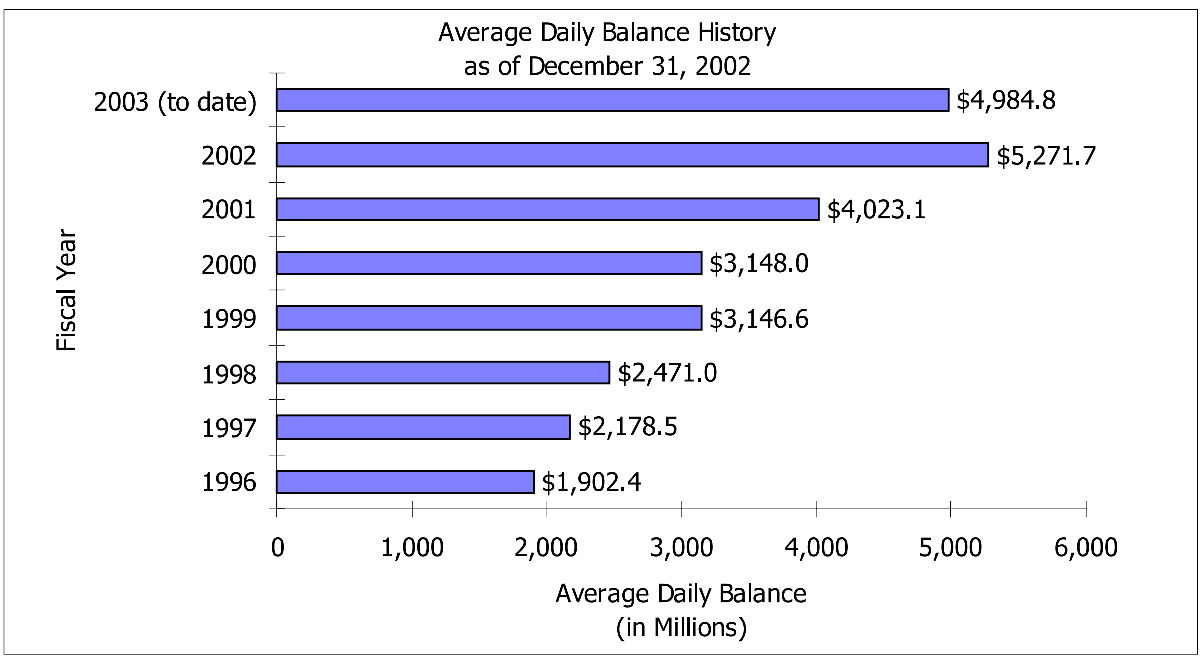
In "Managing Average Life - Part 2," in the next newsletter, we'll discuss evaluating the impact of proposed trades.

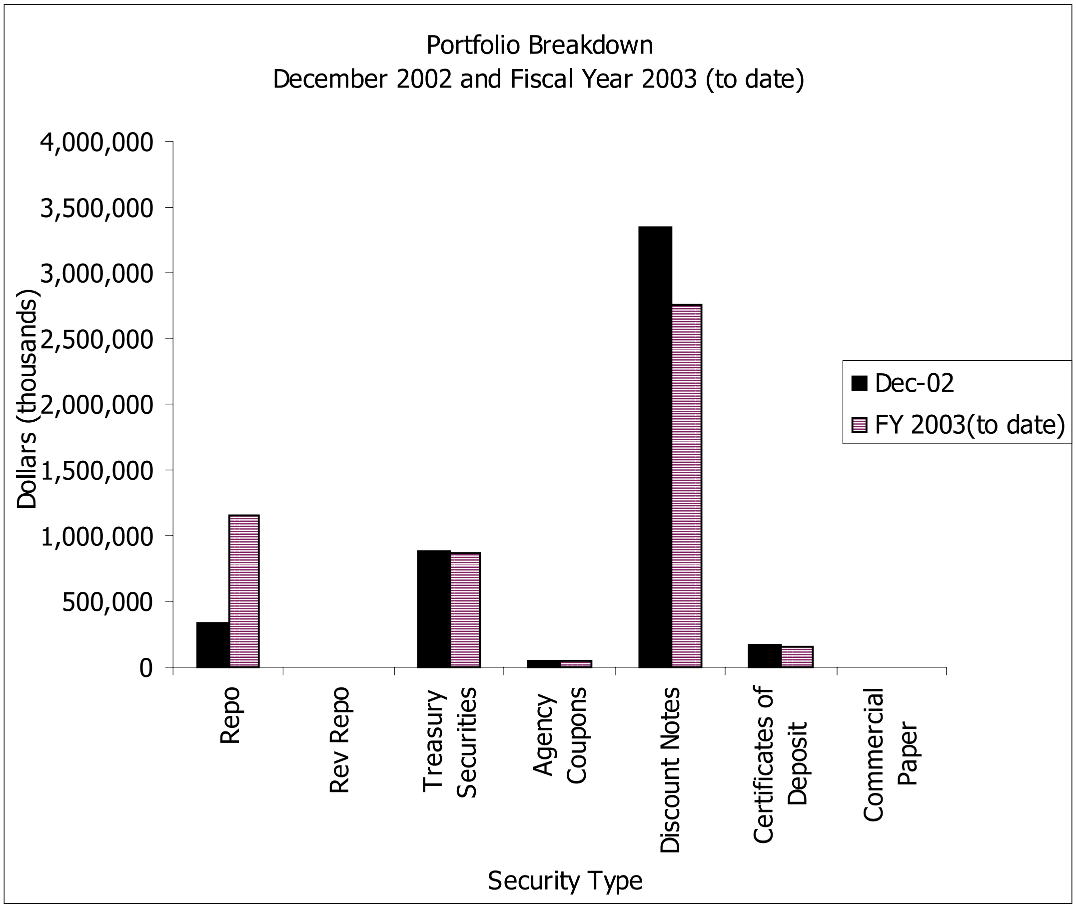

LGIP Maturity Structure
as of December 31, 2002
Amount Maturing
($'s in Millions)
2,800
2,400
2,000
1,600
1,200
800
400
0
1
30
60
90
120
180
270
397
Days to Maturity

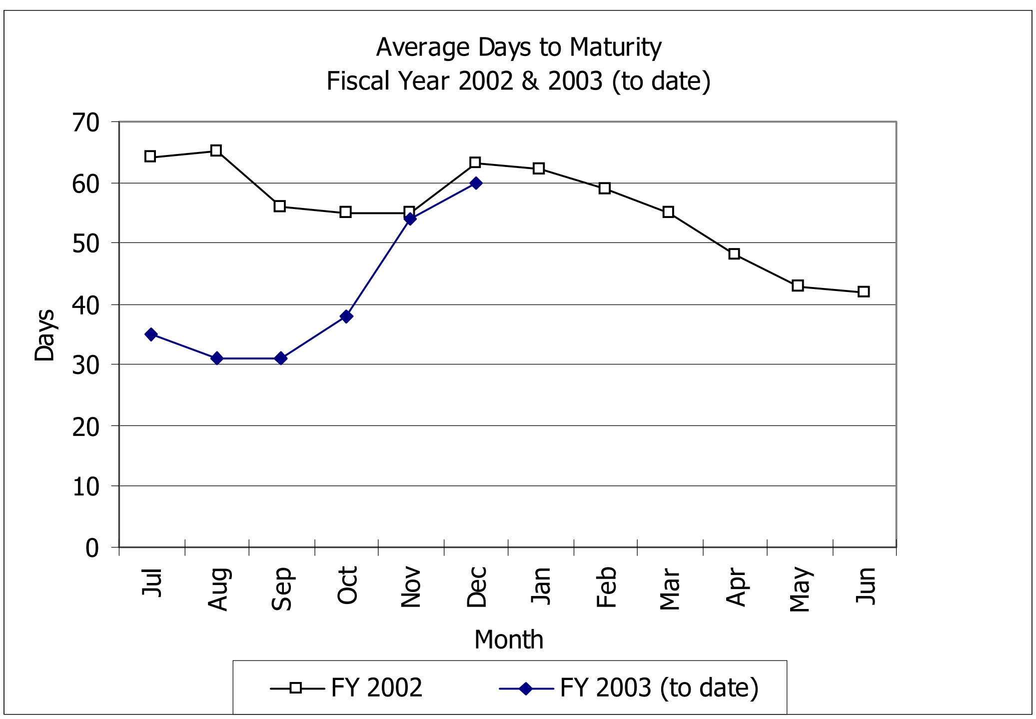

LGIP Cumulative Maturity Structure
as of December 31, 2002
Cumulative Maturities (%)
100%
80%
60%
40%
20%
0%
1
30
60
90
120
180
270
397
Days to Maturity



Total number of accounts: 557




Portfolio Breakdown
December 2002 and Fiscal Year 2003 (to date)
Dollars (thousands)
4,000,000
3,500,000
3,000,000
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
Repo
Rev Repo
Treasury Securities
Agency Coupons
Discount Notes
Certificates of Deposit
Commercial Paper
Security Type
Dec-02
FY 2003(to date)


Average Days to Maturity
Fiscal Year 2002 & 2003 (to date)
Days
70
60
50
40
30
20
10
0
Jul
Aug
Sep
Oct
Nov
Dec
Jan
Feb
Mar
Apr
May
Jun
Month
FY 2002
FY 2003 (to date)

Washington State Local Government Investment Pool
Position and Compliance Report
as of December 31, 2002
(Settlement Date Basis)

LGIP Portfolio Holdings

		Cost	Percentage of Portfolio
Repurchase Agreements	$	203,676,000	4.24
U.S. Treasury Securities		126,200,213	2.63
U. S. Agency Bullets		50,471,900	1.05
U.S. Agency Generic Floaters		....	0.00
U.S. Agency Discount Notes		4,257,380,335	88.70
Certificates of Deposit		162,394,451	3.38
Bankers Acceptances		....	0.00
Commercial Paper		....	0.00
Reverse Repos		....	0.00
***Total Excluding Securities Lending**	$	4,800,122,900	100.00

Securities Lending Holdings *(updated on day lag)*

	Cost
Repurchase Agreements	
Banker's Acceptances	
Commercial paper	
Total Securities Lending	-

Total Investments & Certificates of Deposit $ 4,800,122,900

Policy Limitations

The policy limitations include investment of cash collateral by a securities lending agent calculated as percentages of the portfolio holdings Total Excluding Securities Lending.*

Size Limitations	Holdings	Percentage of Portfolio	Policy Limitations Percentage
Certificates of Deposit	162,394,451	3.38	10%
Bankers Acceptances (BA)	....	0.00	20%
Commercial Paper (CP)	....	0.00	25%
Securities With Higher Volatility	....	0.00	10%
Repos Beyond 30 days	....	0.00	30%
Aggregate BA & CP Holdings	....	0.00	35%

Leverage (30% Total Limit)		
Securities on Loan (dollars out on loan)	$................................	
Reverse Repos	....	
Total Leverage	$................................	0.00%

Maturity Limitations	Currently	Policy Limitations
Portfolio Average Life	60 days	90 days
Maximum Maturity	304 days	397 days
Maximum Maturity of Repo	2 days	180 days
Maximum Maturity of Reverse Repo	0 day(s)	90 days
Average Life of Reinvestment of Cash by Lending Agent	2 day(s)	14 days

Policy Limitations (Continued)

Repo Limits Per Dealer	**December 31, 2002**	**Total Repo Percentage (20% limit)**	**Term Repo Percentage (10% limit)**	**Projected Redemptions 1/2/03**	**Projected Position 1/2/03**
ABN AMRO Inc.	$................................	0%	0%		....
Banc of America Securities LLC	150,000,000	3%	0%	150,000,000	....
Banc One Capital Markets	....	0%	0%		....
Bank of New York	....	0%	0%		....
Barclays Capital Markets	....	0%	0%		....
Bear Stearns & Co.	....	0%	0%		....
CS First Boston	....	0%	0%		....
Chase Manhattan	....	0%	0%		....
Daiwa Securities America Inc.	....	0%	0%		....
Deutsche Bank Securities Inc.	....	0%	0%		....
Dresdner Securities USA	....	0%	0%		....
Goldman Sachs & Co.	....	0%	0%		....
Greenwich Capital Markets Inc.	....	0%	0%		....
Lehman Brothers Inc.	53,676,000	1%	0%	53,676,000	....
Merrill Lynch & Co., Inc.	....	0%	0%		....
Mizuho Securities USA Inc.	....	0%	0%		....
Morgan Stanley	....	0%	0%		....
Nesbitt Burns	....	0%	0%		....
Nomura Securities Intl Incorporated	....	0%	0%		....
Paribas Corporation	....	0%	0%		....
Prudential Securities	....	0%	0%		....
Salomon-Smith Barney	....	0%	0%		....
UBS Warburg LLC	....	0%	0%		....
Total	$ 203,676,000			203,676,000	....

Issuer Limitations ** Commercial Paper	**Cost**	**Percentage (5% limit)**	**Rating (A1/P1 or Better)**

There was no commercial paper holdings as of 12/31/02.

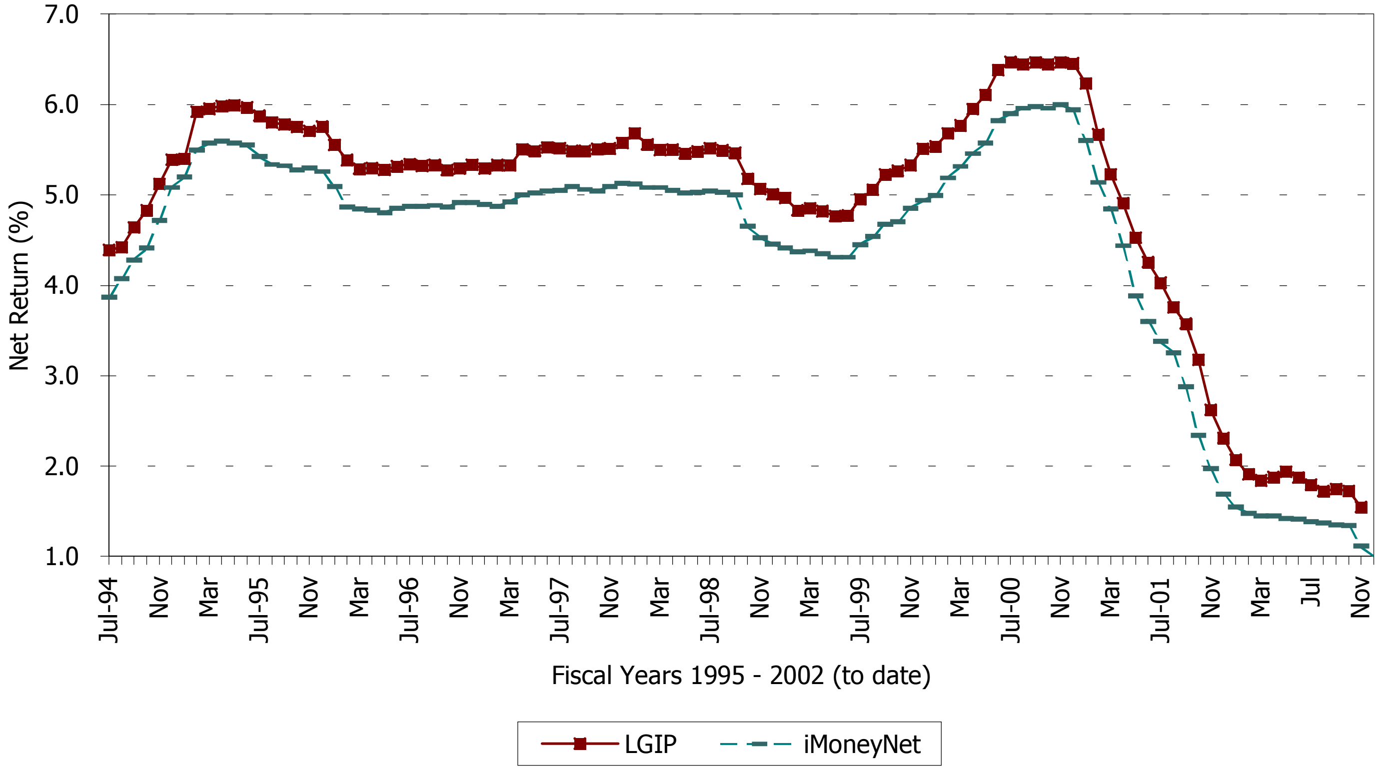
Banker's Acceptances

There was no banker's acceptance holdings as of 12/31/02.

** These are the limitations of the formal Investment policy. However, operating guidelines place limits of 3% per issuer.

LGIP Performance Comparison

iMoneyNet, Inc., Government Only/Institutional Only
versus
Local Government Investment Pool



Net Rate of Return
Fiscal Years 1995 – 2002 (to date)

Average Net Rate of Return of Government Only/Institutional Only Money Market Funds, Money Market Insight, iMoneyNet, Inc., Westborough, MA.

NOTE: Rates are calculated on a 360-day basis.

The above comparison shows how the LGIP has performed relative to its benchmark since July 1994. This benchmark is the iMoneyNet, Inc., Government Only/Institutional Only Money Market Funds, which is comprised of privately managed money market funds similar in composition and investment guidelines to the LGIP.

The LGIP net rate of return has outperformed its benchmark since July 1994 by an average of 47.5 basis points. This translates into the LGIP earning $123.77 million over what the average comparable private money fund would have generated.

Local Government Investment Pool

STATEMENT OF NET ASSETS
December 31, 2002

Assets		
Investments, at Amortized Cost:		
Repurchase Agreements		203,676,000
U.S. Agency Coupons		50,383,240
U.S. Agency Discount Notes		4,260,293,088
U.S. Treasury Securities		126,086,893
Total Excluding Securities Lending		4,640,439,221
Securities Lending Investments, at amortized cost:		
Repurchase Agreements		222,857,305
Total Investments (Settlement/Trade Date Basis)		4,863,296,526
Certificates of Deposit		162,394,451
Cash		1,100,579
Interest Receivable		1,761,869
Total Other Assets		165,256,899
Total Assets		5,028,553,425
Liabilities		
Accrued Expenses		637,147
Obligations under Securities Lending Agreement		222,857,305
Total Liabilities		223,494,452
Net Assets	$	4,805,058,973
Participant Net Asset Value, Price per Unit	$	1.00
Total Amortized Cost - Settlement Date Basis	$	5,025,690,977

QUARTER AT A GLANCE
October 1, 2002 - December 31, 2002

Total investment purchases:	$	31,637,893,116
Total investment sales:	$	4,545,342,999
Total investment maturities:	$	27,731,713,748
Total net income:	$	20,090,051
Net of realized gains and losses:	$	823,218
Net Portfolio yield (360-day basis):		
	October	1.7264%
	November	1.5474%
	December	1.4525%
Average weighted days to maturity:		60 days

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